FATALPHA
VALUE INVESTING

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By
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INSIDE CURRENT ISSUE

"High debt levels, whether in the public or private sector, have historically placed a drag on growth and raised the risk of financial crisis that spark deep economic recessions."

- The McKinsey Institute

March was an outstanding month for the strategy as the portfolio closed up 1.8% vs -1.7% for the S&P 500. For the quarter, FatAlpha is up 6.5% vs 0.4% for the market. A reader, whom I told the performance to, asked what I did to achieve this result. Simply, just continued doing what I've been doing. Yes, KISS principal. Like I've always said if your method is solid then the returns will come. The best performers were CTB (+13%), ACCO (+9%) and SANM (+7%). CTB has gained 23% in the last two months. The worst performers were old school tech HPQ (-11%) and XRX (-6%).

During my trip to London I went by a Shake Shack and tried out the burger of this newly listed company. Check out the report and view on the stock I wrote for Seeking Alpha here: http://goo.gl/TSQILx

The markets and many investors love to get all worked up during the Fed meetings and when rates will go up. A lot of it is media hype and I don't think investors should pay much attention. For the simple reason, that any rate hike doesn't mean diddly-squat! Will 25 bps really make a difference? Theoretically, it's a meaningless increase to any discount factor investors and analysts use and thus doesn't really change valuations. And from a debt side, I don't see many debt deals getting cancelled over 25 bps. On the other hand, there is the issue of perception by the market. Participants may say a rate hike means the economy is strong and thus buy the market. Many investment professionals believe we are out of the woods and need to start normalizing rates.

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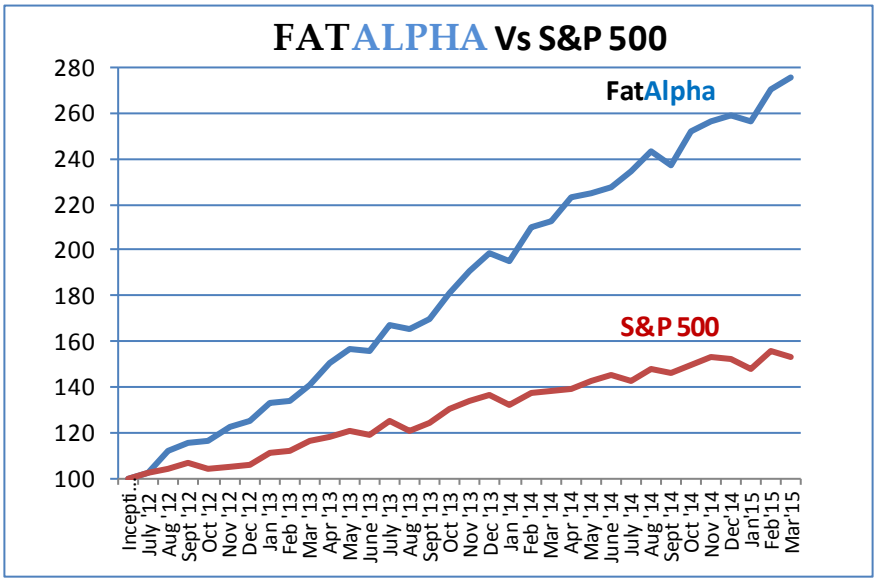
Performance

MONTHLY PERFORMANCE								
Yr/Mo	2015		2014		2013		2012	
	FatAlpha	S&P 500	FatAlpha	S&P 500	FatAlpha	S&P 500	FatAlpha	S&P 500
January	**-0.83%**	-3.10%	**-1.76%**	-3.56%	**6.45%**	5.04%		
February	**5.49%**	5.49%	**7.64%**	4.31%	**0.71%**	1.11%		
March	**1.84%**	-1.74%	**0.91%**	0.69%	**5.35%**	3.60%		
April			**5.08%**	0.62%	**6.47%**	1.81%		
May			**0.97%**	2.10%	**4.19%**	2.08%		
June			**0.83%**	1.91%	**-0.73%**	-1.50%		
July			**3.17%**	-1.51%	**7.45%**	4.95%	**2.89%**	2.13%
August			**3.67%**	3.77%	**-1.00%**	-3.13%	**9.12%**	1.98%
September			**-2.39%**	-1.55%	**2.78%**	2.97%	**3.03%**	2.42%
October			**6.21%**	2.32%	**6.26%**	4.46%	**0.66%**	-1.98%
November			**1.78%**	2.45%	**5.50%**	2.80%	**5.58%**	0.28%
December			**0.86%**	-0.42%	**4.34%**	2.36%	**1.79%**	0.71%
Year	**6.53%**	0.44%	**29.95%**	11.39%	**59.01%**	29.60%	**25.14%**	5.60%
FatAlpha beat S&P 500 26 out of 33 times								

S&P DOWN MONTHS		
Month	FatAlpha	S&P 500
Oct-12	**0.66%**	-1.98%
Jun-13	**-0.73%**	-1.50%
Aug-13	**-1.00%**	-3.13%
Jan-14	**-1.76%**	-3.56%
Jul-14	**3.17%**	-1.51%
Sep-14	**-2.39%**	-1.55%
Dec-14	**0.86%**	-0.42%
Jan-15	**-0.83%**	-3.10%
Mar-15	**1.84%**	-1.74%
Average	**-0.02%**	-2.05%
Median	**-0.73%**	-1.74%
FatAlpha beat S&P 500 8 out 9 times		



SINCE INCEPTION:	FatAlpha	175.5%	Vs	S&P 500	53.1%

Reviews

So far this year this section has reviewed a book and a newsletter. To add variety I've decided to add a website review this month. The website is the Association of American Investors (www.aaii.com).

AAII is probably most known for its Sentiment Survey. AAII polls its over 160,000 members on a weekly basis via e-mail. Members are asked if they are bullish, neutral or bearish on the market. Extreme readings may have some contrarian predictability. An article titled "Is the AAII Sentiment Survey a Contrarian Indicator?" can be found here: http://goo.gl/JpGGbX

The website contains quite a lot of information along with numerous articles on investing, financial planning, technical analysis, stocks, bonds, funds, and other related subjects. These are written by a great variety of authors including professors and market practitioners.

Possibly the most valuable feature is the stock screens area. Here a member can read about 74 different screens. The screens are run every month and members have access to the list of companies that pass. More importantly, readers can read some background information about the screens themselves. Historical performance on each screen is also shown including year-to-date, 1-year, 5-year, and 10-year. In others words if you don't have access to a more sophisticated screen and can't be bothered or have the time to run various screens then this is a very good solution as AAII does all the work for you. Remember the Piotroski screen displayed in last month's letter? Well according to AAII it was the best performing screen over 3-years and 5-years! Personally I do not use this so I cannot comment on its accuracy, however at $29 a year, it looks like a steal. My advice to anyone who decides to use the screens would be to understand what the screen is doing and make sure the output is based on correct data (eg. If low P/E is a criterion then a company with abnormal income may pop up on a screen when it shouldn't). So if you see abnormal income then perhaps the quantitative screen made a mistake… Garbage in, garbage out…

CHECK THIS OUT!

- For those of you who know the E-trade baby commercials then click ahead to see the parody. To give you some background, E-trade brokerage firm in the U.S. used babies in commercials. These babies where always trading and making money using their computers. This parody has a different outcome... Extremely funny and entertaining: https://www.youtube.com/watch?v=AYrpROr9Gmk&t=18

- Sick of your country and paying too much in taxes? Then this article can guide you to a sunny place with no taxes: http://www.bloomberg.com/news/articles/2015-03-11/passport-king-christian-kalin-helps-nations-sell-citizenship

- This guy made a killing financing penny stock companies: http://www.bloomberg.com/news/articles/2015-03-12/josh-sason-made-millions-from-penny-stock-financing

- Did you know there are more Uber cars than yellow cabs in NY!!! http://nypost.com/2015/03/17/more-uber-cars-than-yellow-taxis-on-the-road-in-nyc/

- Zerohedge thinks that Greeks may have a case regarding WWII demands for compensation: http://www.zerohedge.com/news/2015-03-22/looks-germany-may-have-pay

- Buffett's latest letter: http://www.berkshirehathaway.com/letters/2014ltr.pdf

- Welcome to MS-Dos Mobile! (April Fool's joke – I got a kick out of this): https://www.youtube.com/watch?v=irJQDGw8Ptk

- Wondered how some of these startups got crazy valuations. Downside protection (eg. " senior liquidation preference, ensures that a certain group gets its money back before anyone else, including employees"). Thanks Jeff for this. See: http://www.bloomberg.com/news/articles/2015-03-17/the-fuzzy-insane-math-that-s-creating-so-many-billion-dollar-tech-companies

Trades

Date: **March 19th & 26th, 2015**
Ticker: ARW
Name: Arrow Electronics
Transaction: Bought
Price: $61.96 & $59.98
Size: New position

Note:
Readers will remember ARW as this is the second time I'm involved in the name. It was at a much lower level but relative valuations have risen. Arrow Electronics is one of the largest global IT distribution companies. As a result of its size it achieves operational advantages compared to its competitors. Arrow offerings include higher-end complex solutions compared to volume distributors such as TECD and Ingram Micro. This a value play with a 7% FCF yield, and despite the acquisitions ARW does, they are smaller, and fundable from operating without need to raise debt. On the contrary, long-term debt is down and the company has done buybacks. Sales have risen for the last 7 quarters, EPS for the last 6, and operating income growth is 5 for 6. Forward guidance for next quarter implies growth vs a year ago. Only concerns is the low margin (nature of business) and the weak Euro which could have a larger impact than expected as the company is using a 1.14 average. Despite this, the guidance range is 1.27-1.39 (much higher than the 1.14 a year ago) and cheapness provides a cushion.

Date: **March 13th, 2015**
Ticker: KSS
Name: Kohl's Corp
Transaction: Bought
Price: $74.05
Size: New position

Note:
Kohl's has over 1000 department stores with a variety of products including apparel, accessories, footwear, and home products. The stores are located off-mall which results in better economics and margins vs competitors. The stock has appeared has appeared before in my models however it was not purchased as operationally the company was still experimenting which how to recover and operating income was declining in the teens. This last quarter however things changed as sales, operating income and EPS were all up for the first time in a while. Various initiatives are expected to help push sales up 1.8-2.8% in 2015 with and EPS range of $4.40-4.60. The loyalty program "Yes2You" started in 2014 appears be a success, while increased focus on beauty, health and national brands are expected to help. This company also has a FCF yield of 7% and has already been rewarded by investors as the stock price momentum has been strong.

Date: **March 11th, 2015**
Ticker: ANF
Name: Abercrombie & Fitch
Transaction: Bought
Price: $21.30
Size: New position

Note:
The well-known fashion retailer is going through tough times with bad press, image/brand issues, a step down of its CEO since 1992, and some poor results that many use as proof the A&F is no longer a favorite among teens. Despite this, the stock is trading under 4x EV/EBITDA, with an improvement in FCF, and a 10% lower share count. All music to my ears, and a few others, as the stock rose after the initially sell off to below $20. But both the company and the stock are far from being out of the woods, so a smaller than normal position was initiated.

Date: **March 10th, 2015**
Ticker: TRN
Name: Trinity Industries
Transaction: Bought
Price: $29.76
Size: Added to position

Note:
The stock sold off after a downgrade to equal weight by Stephens. I judged the move to be excessive, and took the opportunity to add.

Commentary (Continued from page 1)

I have a different view. We are at or very close to normalized rates – the new normalized rates. US economic data has not been as wonderful as some claim, but more importantly people forget how much leverage there is in the world. According to a report by McKinsey (see: http://goo.gl/u2DUQd) since the financial crisis there is $57 trillion more debt in the world. As a percentage of GDP, it has risen to 286% vs 269% in 2007 and 246% in 2000. No deleveraging = no return to normal. This debt drag will result in a low growth world with little at all inflation. Hence interest rates will remain low worldwide. (Special thanks to John Mauldin for highlighting the quote in his March 28th letter which I also have decided to use).

I don't think this has sunk in yet. I am siding with the Ray Dalio (google Bridgewater for more) and the other doves, as the global conditions mean that the U.S. Fed should remain "patient". (A rate hike will only make the USD more attractive which will result in an even bigger earnings' shocks. The majority of guidance given by companies I have looked estimate a weaker dollar. Hence there will be EPS misses even without the hike. So we have weaker earnings and a weak global economy. Can the U.S. rising out of this and be an engine of growth,

thus needed a rate hike? While I believe the US will perform better than other economies, the U.S. is not an island and its growth will not be something to write home about. It would be better for the Fed to be late rather than risk a premature rate hike which could push the U.S. economy in reverse. This may not only result in a drop in the S&P but a shift to a global risk off trade. Having said that, the Fed may see all this and hence the delay in the rate hike. Therefore it is likely that we get a 25 bps hike in September or December accompanied by language that there won't be much in hikes for a while.

Four out of five fund managers said bonds were overvalue (see FT article http://goo.gl/bGP1pL). No arguments here with all the negative yields we are seeing in Europe. Risk is not priced correctly, and as globally rates are benchmarked to the European and US rates, the risk is mispriced globally. The biggest bubble of all is not in equities but in bonds. But didn't I just say that rates should remain low? Yes, however that does not mean that 2 year Spain should be at 0% and Indonesia at 1.6%. Not to mention the high risk ventures (like biotechs) getting access to free money. Why shouldn't spreads be wider? More risk, higher yield. But the bond market is now Nasdaq of 2000 with the greater fool theory at full throttle. A shake up in the global markets will result is a magic act – the disappearance of liquidity. No buyers, margin calls, forced sellers. And all these ETFs will only make matters worse.

Now this crash will occur at some point in the near future. I'm not saying a rate hike will trigger it but if combined with some other event, then perhaps. There is always the hope that reforms are put in place and there is a global deleveraging, but the most likely scenario is that at some point a series of events will bring on another crash. This could be a Greek default and/or an escalation of some war. It's impossible to know in advance, but investors will see blood. The only thing an investor can do is be prepared and have a plan. But at the end of the day this is all just good discussion. I am no genie and I am very happy I am not a macro guy but a simple value investor who goes about his way picking stocks that form a portfolio that beats the market.